Clinton, Republicans agree to deregulation of US financial system

By Martin McLaughlin
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An agreement between the Clinton administration and congressional Republicans, reached during all-night negotiations which concluded in the early hours of October 22, sets the stage for passage of the most sweeping banking deregulation bill in American history, lifting virtually all restraints on the operation of the giant monopolies which dominate the financial system.

The proposed Financial Services Modernization Act of 1999 would do away with restrictions on the integration of banking, insurance and stock trading imposed by the Glass-Steagall Act of 1933, one of the central pillars of Roosevelt's New Deal. Under the old law, banks, brokerages and insurance companies were effectively barred from entering each others' industries, and investment banking and commercial banking were separated.

The certain result of repeal of Glass-Steagall will be a wave of mergers surpassing even the colossal combinations of the past several years. The *Wall Street Journal* wrote, "With the stroke of the president's pen, investment firms like Merrill Lynch & Co. and banks like Bank of America Corp., are expected to be on the prowl for acquisitions." The financial press predicted that the most likely mergers would come from big banks acquiring insurance companies, with John Hancock, Prudential and The Hartford all expected to be targeted.

Kenneth Guenther, executive vice president of Independent Community Bankers of America, an association of small rural banks which opposed the bill, warned, "This is going to begin a wave of major mergers and acquisitions in the financial-services industry. We're moving to an oligopolistic situation."

One such merger was already carried out well before the passage of the legislation, the $72 billion deal which brought together Citibank, the biggest New York bank, and Travelers Group Inc., the huge insurance and financial services conglomerate, which owns Salomon Smith Barney, a major brokerage. That merger was negotiated despite the fact that the merged company, Citigroup, was in violation of the Glass-Steagall Act, because billionaire Travelers boss Sanford Weill and Citibank CEO John Reed were confident of bipartisan support for repeal of the 60-year-old law.

They had good reason, to be sure. The banking, insurance and brokerage industry lobbyists have combined their forces over the last five years to mount the best-financed campaign of influence-buying ever seen in Washington. In 1997 and 1998 alone, the three industries spent over $300 million on the effort: $58 million in campaign contributions to Democratic and Republican candidates, $87 million in "soft money" contributions to the Democratic and Republican parties, and $163 million on lobbying of elected officials.

The chairman of the Senate Banking Committee, Texas Republican Phil Gramm, himself collected more than $1.5 million in cash from the three industries during the last five years: $496,610 from the insurance industry, $760,404 from the securities industry and $407,956 from banks.

During the final hours of negotiations between the House-Senate conference committee and White House and Treasury officials, dozens of well-heeled lobbyists crowded the corridors outside the room where the final deal-making was going on. Edward Yingling, chief lobbyist for the American Bankers Association, told the *New York Times*, "If I had to guess, I would say it's probably the most heavily lobbied, most expensive issue" in a generation.

While Democratic and Republican congressmen and industry lobbyists claimed that deregulation would spark competition and improve services to consumers, the same claims have proven bogus in the case of telecommunications, airlines and other industries freed from federal regulations. Consumer groups noted that since the passage of a 1994 banking deregulation bill which permitted bank holding companies to operate in more than one state, both checking fees and ATM fees have risen sharply.

Differing versions of financial services deregulation passed the House and Senate earlier this year, and the conference committee was called to work out a consensus bill and avert a White House veto. The principal bone of contention in the last few days before the agreement had nothing to do with the central thrust of the bill, on which there was near-unanimous bipartisan support.

The sticking point was the effort by Gramm to gut the Community Reinvestment Act, a 1977 anti-redlining law which requires that banks make a certain proportion of their loans in minority and poor neighborhoods. Gramm blocked passage of a similar deregulation bill last year over demands to cripple the CRA, and bank lobbyists were in a panic, during the week before the deal was made, that the dispute would once again prevent any bill from being adopted.

Gramm and other extreme-right Republicans saw the opportunity to damage their political opponents among minority businessmen and community groups, who generally support the Democratic Party. Gramm succeeded in inserting two provisions to weaken the CRA, one reducing the frequency of examinations for CRA compliance to once every five years for smaller banks, the other compelling public disclosure of loans made under the program.

The latter provision was particularly offensive to black and other minority business and community groups, who have used the CRA provisions as a lever by threatening to challenge mergers and other bank operations which require government approval. In most such cases, the banks have offered loans to businessmen or outright grants to community groups in return for dropping their legal actions. These petty-bourgeois elements have been able to posture as defenders of the black or Hispanic community, while pocketing what are essentially payoffs from finance capital and concealing from the public the details of this relationship.

The banks and other financial institutions did not themselves oppose continuation of the CRA, which they have treated as nothing more than a cost of doing a highly profitable business in minority areas. Loans tied to the CRA average a 20 percent rate of return. Financial industry lobbyists complained that they were being caught in a crossfire between the Republicans and Democrats which was unrelated to the main purpose of the bill.

The Clinton White House threatened to veto the bill if CRA provisions were substantially weakened, in response to heavy pressure from the Congressional Black Caucus and the Reverend Jesse Jackson, whose Operation PUSH has made extensive use of CRA in its campaigns to pressure corporations and banks for more opportunities for black businessmen. But eventually the White House caved in to Gramm, accepting his amendments so long as the program remained formally in place.

The White House similarly retreated on pledges that consumer privacy would be protected in the legislation. Consumer groups pointed to the potential for abuse of financial information once giant conglomerates were created which would handle loans, investments and insurance at the same time. For example: a bank could refuse to give a 30-year mortgage to a customer whose medical records, filed with the bank's insurance subsidiary, revealed a fatal disease.

The final draft of the bill contains a consumer privacy protection clause, but it is extremely weak, applying only to the transfer of information outside of a financial conglomerate, not within it. Thus Citigroup will be able to pass on financial information about its bank depositors to Travelers Insurance, but not to an outside company like Prudential. Even that limitation would be breached if there was a contractual relationship with the outside company, as in the case of a telemarketer which did work for Citigroup and was given private information about Citigroup depositors to aid in its telephone solicitations.

The proposed deregulation will increase the degree of monopolization in finance and worsen the position of consumers in relation to creditors. Even more significant is its impact on the overall stability of US and world capitalism. The bill ties the banking system and the insurance industry even more directly to the volatile US stock market, virtually guaranteeing that any significant plunge on Wall Street will have an immediate and catastrophic impact throughout the US financial system.

The Glass-Steagall Act of 1933, which the deregulation bill would repeal, was not adopted to protect consumers, although one of its most celebrated provisions was the establishment of the Federal Deposit Insurance Corporation, which guarantees bank deposits of up to $100,000. The law was enacted during the first 100 days of the Roosevelt administration to rescue a banking system which had collapsed, wiping out the life savings of millions of working people, and threatening to bring the profit system to a complete standstill.

As a recent history of that era notes: "The more than five thousand bank failures between the Crash and the New Deal's rescue operation in March 1933 wiped out some $7 billion in depositors' money. Accelerating foreclosures on defaulted home mortgages—150,000 homeowners lost their property in 1930, 200,000 in 1931, 250,000 in 1932—stripped millions of people of both shelter and life savings at a single stroke and menaced the balance sheets of thousands of surviving banks" (David Kennedy, *Freedom from* University Press, 1999, pp. 162-63).

The separation of banking and the stock exchange was ordered in response to revelations of the gross corruption and manipulation of the market by giant banking houses, above all the House of Morgan, which organized huge corporate mergers for its own profit and awarded preferential access to share issues to favored politicians and businessmen. Such insider trading played a major role in the speculative boom which preceded the 1929 crash.

Over the past 20 years the restrictions imposed by Glass-Steagall have been gradually relaxed under pressure from the banks, which sought more profitable outlets for their capital, especially in the booming stock market, and which complained that foreign competitors suffered no such limitations to their financial operations. In 1990 the Federal Reserve Board first permitted a bank (J.P. Morgan) to sell stock through a subsidiary, although stock market operations were limited to 10 percent of the company's total revenue. In 1996 this ceiling was lifted to 25 percent. Now it will be abolished.

The *Wall Street Journal* celebrated the agreement to end such restrictions with an editorial declaring that the banks had been unfairly scapegoated for the Great Depression. The headline of one *Journal* article detailing the impact of the proposed law declared, "Finally, 1929 Begins to Fade."

This comment underscores the greatest irony in the banking deregulation bill. Legislation first adopted to save American capitalism from the consequences of the 1929 Wall Street Crash is being abolished just at the point where the conditions are emerging for an even greater speculative financial collapse. The enormous volatility in the stock exchange in recent months has been accompanied by repeated warnings that stocks are grossly overvalued, with some computer and Internet stocks selling at prices 100 times earnings or even greater.

And there is a much more recent experience than 1929 to serve as a cautionary tale. A financial deregulation bill was passed in the early 1980s under the Reagan administration, lifting many restrictions on the activities of savings and loan associations, which had previously been limited primarily to the home-loan market. The result was an orgy of speculation, profiteering and outright plundering of assets, culminating in collapse and the biggest financial bailout in US history, costing the federal government more than $500 billion. The repetition of such events in the much larger banking and securities markets would be beyond the scope of any federal bailout.